SURREY
COUNTY COUNCIL

Audit & Governance Committee
27 July 2015

TREASURY MANAGEMENT OUTTURN REPORT 2014/15

SUMMARY AND PURPOSE:

This report summarises the council's treasury management activity during 2014/15, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management. The report also covers the council's Prudential Indicators for 2014/15, in accordance with the requirements of the CIPFA Prudential Code for Capital Finance in Local Authorities.

RECOMMENDATIONS:

It is recommended that:

1) the Committee note the content of the Treasury Management Annual Report for 2014/15; and
2) adopt the revised Treasury Management Risk Register shown in Annex 3.

BACKGROUND:

1. Treasury management is defined as the management of the organisation's cash flows, banking, money market and capital market transactions, the effective management of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.

TREASURY MANAGEMENT ANNUAL REPORT 2014/15:

Key Prudential Indicators and Compliance Issues

2. Under CIPFA's Prudential Code, the council is required to report on its actual Prudential Indicators after the year end. Annex 1 Table 11 provides a schedule of all of the council's mandatory Prudential Indicators relating to treasury management, as agreed at the budget meeting of 11 February 2014. Key indicators that provide either an overview or a limit on treasury activity are summarised in the following paragraphs.

3. The Capital Financing Requirement (CFR) shows the council's underlying need to borrow for capital purposes. To ensure that, over the medium term, borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short-term, exceed the total CFR at the end of the previous year plus any increase in the CFR anticipated at the end of the current and next two financial years. The council has complied with this requirement as shown in Table 1:

Table 1: Borrowing Position Against CFR

	£m
Total Borrowing at 31 March 2015	397
Investments at 31 March 2015	152
Net borrowing position at 31 March 2015	**245**
CFR 2014/15	682
CFR 2015/16	782

4. Table 2 sets out the long-term borrowing position and the new loans taken out in 2014/15.

Table 2: Long-term borrowing

	£m
Debt outstanding as at 1 April 2014	237.2
Loans raised	160.0
Loans repaid	0.0
Current balance as at 31 March 2015 **Average Rate going forward at 1 April 2015: 4.12%**	397.2

5. Table 3 sets out the details of the new loans totalling £160m taken out in 2014/15.

Table 3: New PWLB Loans 2014/15

Start Date	Duration Years	Interest Rate%	£m
02 September 2014	50	3.72	30
15 December 2014	50	3.36	20
20 January 2015	50	2.99	20
16 February 2015	49	3.23	30
27 February 2015	47	3.19	30
19 March 2015	46	3.19	30
		3.29	**160**

6. The Authorised Limit is the council's "affordable borrowing limit" required by section 3(1) of the Local Government Act 2003. This represents the limit beyond which borrowing/external debt is prohibited. The limit reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. Table 4 demonstrates that during 2014/15, the council has maintained gross borrowing within its Authorised Limit.

7. The Operational Boundary is the level of borrowing that the council could reach during the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It includes allowances for unusual but possible events. It acts as an indicator to ensure that the council's Authorised Limit is not breached.

Table 4: Borrowing Against Authorised Limit & Operational Boundary 2014/15

	£m
Authorised Limit	690
Operational Boundary	622
Highest gross borrowing position during 2014/15	442

8 The Minimum Revenue Provision (MRP) is a statutory amount set aside in order to repay the principal amounts of sums borrowed. Capital financing costs (the MRP and interest payments on borrowing) incurred by the council during 2014/15 are detailed as follows:

Table 5: Capital Financing Costs 2014/15

Description	Original Estimate £000	Outturn £000
Minimum Revenue Provision (MRP)	22,327	22,208
Interest on long-term borrowing	11,107	12,636
Interest on short-term cashflow	(808)	(861)
Total	32,626	33,983

9 Interest on long-term borrowing is higher than budget as further borrowing (2014/15 and forward borrowing for 2015/16) was made during the year. Net interest received on short-term cashflow is higher than the estimate due to higher levels of cash on deposit than originally expected.

Treasury Management Activity during 2014/15

10 The treasury position at 31 March 2015 compared with the end of the last financial year is shown in Table 6. The council's credit rating criteria effective at 31 March 2015 are shown at Annex 2 Table 14.

Table 6: Investment and Borrowing Position 2014/15

	2013/14*		2014/15	
	Principal £m	Average Rate	Principal £m	Average Rate
Fixed Interest Rate Debt*	237	4.42%	397	4.53%
Total Debt	**237**	**4.42%**	**397**	**4.53%**
Fixed Interest Investments	102	0.41%	152	0.42%
Total Investments	**102**	**0.41%**	**152**	**0.42%**
NET BORROWING	**135**		**245**	

*Excludes Office of the Police and Crime Commissioner for Surrey debt

11. The treasury management gross borrowing position increased during 2014/15 as a result of further borrowing as undertaken as set out in Table 3.

12. The increase in investment balances is the result of higher cash balances at the end of 2014/15 as a result of the actions described above compared with 2013/14. The average interest rate paid on debt has increased slightly (from 4.42% in 2013/14 to 4.53% in 2014/15) and this is attributable to the repayment of £68.0m debt in 2013/14 which was subject to a lower interest rate than the average of the total portfolio. The consistent rate of investment interest income is due to the stable interest rates available for deposits remaining low in 2014/15.

Borrowing Position

13. The weighted average interest rate on PWLB debt from 2004/05 is shown in Table 7.

Table 7: Interest on PWLB Debt

Financial Year	% Interest on Debt
2004/05	4.96
2005/06	4.86
2006/07	4.73
2007/08	4.45
2008/09	3.59
2009/10	4.20
2010/11	4.20
2011/12	4.20
2012/13	4.20
2013/14	4.42
2014/15	4.53

14. All of the council's current long-term borrowing has been taken from the Public Works Loan Board (PWLB), whose purpose is to provide loans to local authorities in order to finance capital spend, apart from a £10m market loan taken from Barclays. A summary showing the movement of long-term borrowing during 2013/14 and 2014/15 is as follows:

Table 8: Long-Term Borrowing Position

Long-term Borrowing	1 April 2013 to 31 March 2014 £000	1 April 2014 to 31 March 2015 £000
Total debt outstanding at 1 April	305,230	237,247
Loans raised	0	160,000
Loans repaid	67,983	0
Total debt at period end	**237,247**	**397,247**

15. The council is able to undertake temporary borrowing for cash flow purposes. The council also manages cash on behalf of the Office of the Police and Crime Commissioner for Surrey, which is classified as temporary borrowing. The balances outstanding at 31 March 2015 are detailed in Table 9.

Table 9: Temporary Borrowing Position

Temporary Borrowing at 31 March 2015	£000
Short-term borrowing for cash flow purposes	0
Office of the Police and Crime Commissioner for Surrey	31,539
Total Temporary Borrowing	**31,539**

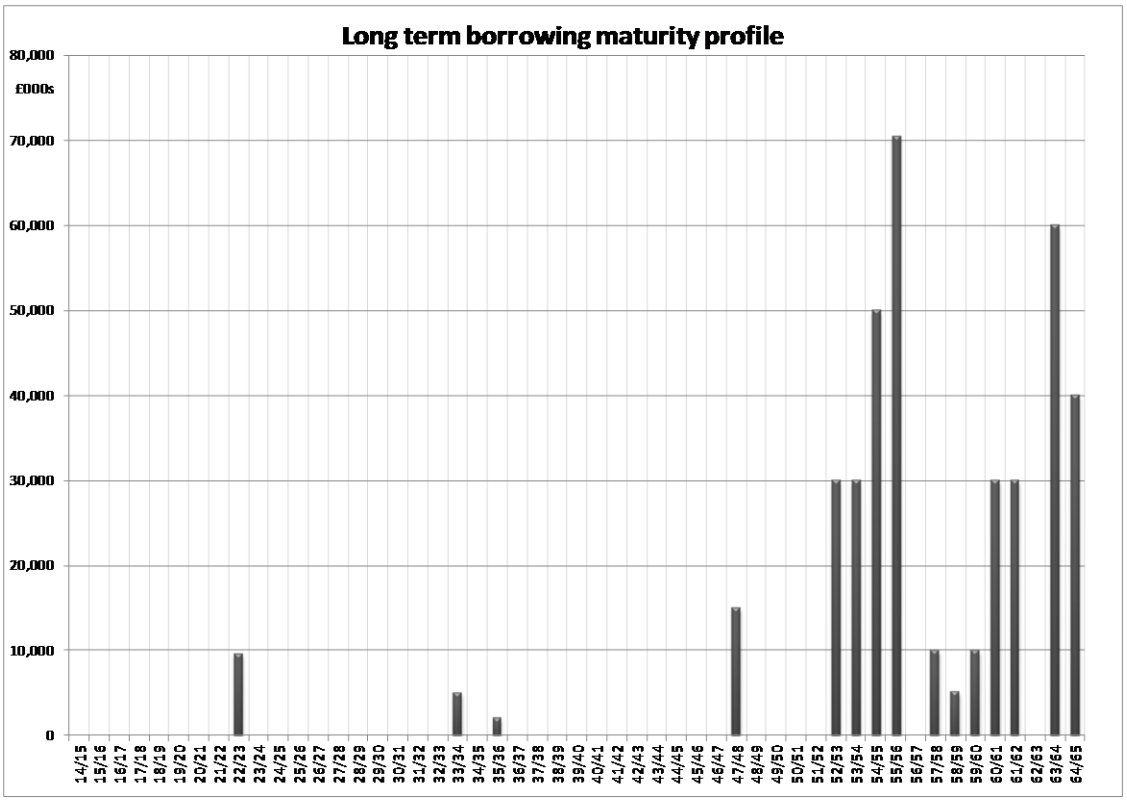
16. The council has limited its exposure to large fixed rate loans maturing in any one year by setting gross limits for its maturity structure of borrowing in accordance with the Prudential Code.

Table 10: Debt Maturity Profile as at 31 March 2015

Maturity Profile	Upper Limit	Lower Limit	Actual
Under 12 months*	50%	0%	7.4%
1 year and within 2 years	50%	0%	0.0%
2 years and within 5 years	50%	0%	0.0%
5 years and within 10 years	75%	0%	2.2%
10 years and above	100%	25%	90.4%

* Includes balances held on behalf of the Office of the Police and Crime Commissioner for Surrey.

17 The debt maturity profile of the council's long-term debt is shown on the following chart:



Investment Position

18. Average investment returns from 2004/2005 onwards are shown in Table 11.

Table11: Return on Investments

Financial Year	% Return on Investments
2004/2005	4.65
2005/2006	4.75
2006/2007	4.90
2007/2008	5.78
2008/2009	4.38
2009/2010	1.01
2010/2011	0.75
2011/2012	0.70
2012/2013	0.55
2013/2014	0.41
2014/2015	0.42

19. The deterioration in the ratings of the majority of banks, coupled with the Bank of England base interest rate sustained at 0.50%, has resulted in very low rates available with a small number of institutions.

20. All cash held by the council is aggregated for the purpose of treasury management and daily surpluses are invested temporarily until required to meet daily outgoings. Such monies include funds held on behalf of schools and the Office of the Police and Crime Commissioner for Surrey. Pension Fund balances are held in a separate bank account.

21. Some 300 schools have their cash balances incorporated within the council's balances, earning interest on an agreed basis. Under this arrangement, these schools receive interest on their balances at a rate of 0.50% below base rate.

22. In 2014/15, the council applied the average return of its whole investment portfolio to all of the funds that were held on behalf of the Office of the Police and Crime Commissioner for Surrey (as per the current service level agreement).

23. Money brokers are used to facilitate investment dealing and loans are only made to institutions that meet the council's approved counterparty criteria. In addition to dealing through brokers, short-term investments are also made by dealing direct with some approved institutions, including banks, building societies and money market funds.

24. Due to frequent action on the part of credit ratings agencies, the council's credit rating criteria, investment limits and resultant counterparty list have been under continual scrutiny. The counterparty criteria set out for the period 1 April 2014 to 31 March 2015, which was affirmed at the County Council meeting of 11 February 2014, is shown in Annex 2, with investment limits effective during that period.

25. During 2014/15, the council maintained an investment portfolio with a daily average balance of £142m (£281m in 2013/14) and received an average return of 0.42%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.35% for the period. The council therefore outperformed its benchmark by 0.07%.

Icelandic Deposits

26. The Audit & Governance Committee has received regular reports on the prospects for recovery of the remaining Icelandic deposits and the efforts made by the Local Government Association (LGA) and its legal advisors in this regard.

27. With regard to Landsbanki, at a meeting of 22 October 2013, the Cabinet authorised, on the Council's behalf, the Local Government Association (LGA) and its legal representatives to arrange an auction of the Council's claim for its deposit with Landsbanki, managed by Deutsche Bank. It authorised the Leader or Cabinet Member for Business Services, in consultation with the Director of Finance and the Monitoring Officer, to make a final decision on the sale price and to report back to the council with an update on the outcome of the auction.

28. The Local Government Association and its legal representatives commenced negotiations with interested third parties on the Council's behalf in order to achieve the best possible price. On 30 January 2014, this was confirmed at a level that satisfied the minimum required stipulated by Cabinet. Proceeds from the sale in the amount of £4,123,006.05 were received into the Council's bank account on 4 February 2014, which includes an amount of interest due on the investment. This concludes the council's debt relationship with Landsbanki.

29. With regard to Glitnir, over 84% of Glitnir deposits had previously been repaid. At a meeting of 3 February 2015, the Cabinet authorised, on the Council's behalf, the Local Government Association (LGA) and its legal representatives to arrange an auction of the Council's claim for its remaining deposit with Glitnir through the Central Bank of Iceland (CBI). It authorised the Director of Finance, in consultation with the Leader, the Cabinet Member for Business Services and the Monitoring Officer, to submit final papers in respect of the auction and to determine the relevant exchange rate bid to be included in the offer.

30. The CBI set the auction price at ISK200/EUR. Therefore, offers submitted at or above ISK201/EUR were accepted in full. Surrey's bid of ISK210/EUR was successful and resulted in a receipt of £1,467,101, received into the Council's bank account on 13 February 2015, which includes an amount of interest due on the investment. This will involve a write off (in respect of the Glitnir deposit) for the Council in the amount of £797,088 against a provision held in the amount of £563,718.

31. The conclusion of the Glitnir auction process draws a final line under the Icelandic investment with the overall loss contained to a single figure percentage of the original investments, amounting to £20,000,000. On 8 June 2015, Iceland announced it was due to end capital controls on deposits with proposals to impose a 39% exit tax on remaining deposits. The possible imposition of such an exit tax was the main factor in the officers' recommendations to proceed with the auction processes as outlined above. The auction processes thus represents a satisfactory conclusion for the Council in its quest to retrieve its deposits following the Icelandic bank crash back in 2008.

Member and Officer Training

32. Officers and members involved in the governance of the council's treasury management function are required to participate in training. Officers are also expected to keep up to date with matters of relevance to the operation of the council's treasury function. Officers continue to keep abreast of developments via the CIPFA Treasury Management Forum as well as through two local authority networks. Capita provides daily, weekly and quarterly newsletters and update meetings are held with Capita twice a year. Members will be given additional training by Capita later in 2015/16.

Treasury Management Advisors

33. The Council uses Capita as its treasury management advisor. The company provides a range of services including:

- technical support on treasury matters, capital finance issues and reports;
- economic and interest rate analysis;
- debt services, which includes advice on the timing of borrowing;
- debt rescheduling advice surrounding the existing portfolio;
- generic investment advice on interest rates, timing, and investment instruments;
- credit ratings/market information service comprising the three credit rating agencies.

Risk

34. A development in the revised CIPFA Code on Treasury Management, which is intended to improve the reporting of treasury management activities, is the consideration, approval and reporting on security and liquidity benchmarks. Yield benchmarks are already widely used to assess investment performance, while discrete security and liquidity benchmarks are new reporting requirements. A Treasury Management Risk Register is included as Annex 3.

Security: The Council analyses the investment portfolio at year end against historic default rates to estimate the maximum exposure to default as shown in Table 10 below:

Liquidity: The Council currently restricts termed deposits to less than one year, and ensures the minimum level of cash available each day stands above £15m. This provides a safety margin to help ensure the Council does not need to borrow to fund treasury activity.

Yield: The Council currently reports the overall return in interest against the 7-Day LIBID rate. The overall return in 2014/15 on deposits was 0.42%, compared with the benchmark of 0.35%, a margin of 0.07%.

Table 12: Benchmarking Deposits against Default Rates at 31 March 2015

Deposits with banks and financial institutions	**Amount £000**	**Historical experience of default %**	**Estimated exposure to default £000**
	(a)	(b)	(a x b)
AAA rated counterparties	43,600	0.00%	0
AA rated counterparties	-	0.02%	0
A rated counterparties	20,000	0.09%	18
Other counterparties*	88,000		0
Total	151,600		18

*other Local Authorities that do not have credit ratings

Regulatory Framework, Risk and Performance

35. The council's treasury management activities are regulated by statute. The DCLG has also issued investment guidance to regulate the Council's investment activities.

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity. The Act permits the Secretary of State to set limits either on the council or nationally on all local authorities, restricting the amount of borrowing which may be undertaken (no restrictions were made in 2014/15);

- Statutory Instrument (SI) 3146 2003, as amended, specifies the controls and powers within the Act. The SI requires the council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities. The SI also requires the council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;

- Under section 238(2) Local Government and Public Involvement in Health Act 2007, the Secretary of State has taken powers to issue guidance on accounting practices.

36. The council has complied with all of the above relevant statutory and regulatory requirements, which require the council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. The adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management ensures that capital expenditure is prudent, affordable and sustainable, and treasury practices demonstrate a low risk approach.

37. The council is aware of the risks of passive management of the treasury portfolio and, with the support of the council's advisors, has proactively managed the debt and investments. The council has utilised historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio, as it consists of predominantly fixed long-term loans, with the capacity for repayment of any shorter dated debt. Shorter term interest rates and likely future movements in these rates predominantly determine the council's investment return. These returns can be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

Risk Register

38. A risk register for the Treasury Management operation is shown in Annex 3.

39. The Committee is invited to comment on the register and propose amendments as appropriate.

IMPLICATIONS:

A) Financial
There are no direct financial implications.

B) Equalities
There are no direct equality implications.

C) Risk management and value for money
See paragraphs 35 to 39.

WHAT HAPPENS NEXT:

i. The Pension Fund & Treasury Team will monitor the UK and overseas banking sector and will continue to update this Committee as appropriate.

ii. In line with the requirements of CIPFA's Code of Practice for Treasury Management, this committee will receive a half year report on the council's treasury management position in December, and a full-year report for 2015/16 at the meeting in July 2016.

iii. The Pension Fund & Treasury Team will prepare the annual Treasury Management Strategy, which will be presented as part of the MTFP to Council in February 2016.

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Sources/background papers:
Capital Budget and Treasury Management Strategy 2014/15
Prudential Indicators and Treasury Management Strategy 2013/14 to 2014/15
CIPFA Code of Practice for Treasury Management in the Public Services (Revised)
CIPFA Treasury Management Benchmarking Club Report 2014/15

Table 13: Summary of Prudential Indicators for 2014/15

Prudential Indicator	Maximum Position 2014/15 £000	Limit 2014/15 £000
Maximum net borrowing incurred against the Capital Financing Requirement (CFR)	246,600	782,000
Maximum gross borrowing incurred against the Authorised Limit	442,500	688,000
Maximum gross borrowing incurred against the Operational Boundary	442,500	619,000
Ratio of financing costs to net revenue stream	4.02%	N/A
Limits on fixed interest rates	100%	100%
Limits on variable interest	0%	0%
Maturity structure of fixed rate borrowing *(maximum position during the year)*		
Under 12 months	7.4%	0% - 50%
12 months to 2 years	0%	0% - 50%
2 years to 5 years	0%	0% - 50%
5 years to 10 years	2.2%	0% - 75%
10 years and above	90.4%	25% - 100%
Maximum principal funds invested for more than 365 days	0%	35% of value of investments held

In addition to the above the council is required as a Prudential Indicator to:

i) Adopt the CIPFA Code of Practice.

ii) Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR).

9

Table 14: Effective counterparty limits 1 April 2014 to 31 March 2015

	Fitch				Moody's			S&P		
Type	ST	LT	Via	Sup	ST	LT	FSR	ST	LT	Maximum Value
Bank / BS	F1	A	-	1	P-2	Baa1	D+	A-2	A-	£60m
Bank / BS	F1	A	a-	1	P-1	A2	D+	A-1	A	£60m
MMF	AAA				AAA			AAA		£20m
DMADF	-				-			-		Unlimited
Supranational	-				-			-		£10m
Local Authority	-				-			-		£20m

i) Deposits are permitted with UK banks that do not comply with the council's credit rating criteria subject to the following:

a) That they have been nationalised or part nationalised by the UK government;

and/or

b) That they have signed up to the UK government financial support package.

ii) The use of Money Market Funds is restricted to Funds with three AAA ratings up to a maximum of £100m (with a maximum of £20m per Money Market Fund).

iii) An additional £40m is made available to invest in overnight high interest call accounts with both RBS and Lloyds (making a total of £60m limit with each). This will be maintained while they remain part nationalised.

iv) Deposits with foreign banks are now permitted, on the condition that they meet our minimum criteria, and that the country in which the bank is domiciled is "AAA" rated with all three ratings agencies (Fitch, Moody's and Standard and Poor's).

GLOSSARY

MMF = Money Market Fund; DMADF = Debt Management Account Deposit Facility at the Bank of England; BS = Building Society. ST = Short-Term; LT = Long-Term; Ind = Individual rating; Sup = Support rating; FSR = Financial Strength Rating.

F1 Indicates the strongest capacity for timely payment of financial commitments; an added "+" denotes any exceptionally strong credit feature.

P-1 Indicates superior credit quality and a very strong capacity for timely payment of short-term deposit obligations. No enhanced rating available.

A- Indicates a strong capacity to meet financial commitments; an added "+" denotes a capacity to meet financial commitments as extremely strong.